DIRECT TESTIMONY
OF
JULIE M. CANNELL

ON BEHALF OF

SOUTH CAROLINA ELECTRIC AND GAS COMPANY

DOCKET NO. 2007-229-E

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS.

A. My name is Julie M. Cannell. My business address is P.O. Box 199, Purchase, New York, 10577.

Q. BY WHOM ARE YOU EMPLOYED?

A. I am president of J.M. Cannell, Inc., which provides advisory services to electric utility companies and other types of firms and organizations with an interest in the industry. My resume is attached as Exhibit ___, (JMC-1)

Q. PLEASE DESCRIBE YOUR EDUCATION AND BUSINESS BACKGROUND.

A. I am a graduate of Mary Baldwin College. I also hold an M.Ln. degree from Emory University and an M.B.A. from Columbia University. I am a Chartered Financial Analyst. Prior to establishing my firm in February 1997, I was employed by the New York-based investment manager, Lord Abbett & Company, from June 1978 to January 31, 1997, as well as the summer of 1977. During my tenure with Lord Abbett, I was a securities analyst specializing in the electric utility and telecommunications services industries; portfolio manager of America's Utility Fund, an equity utility mutual fund; portfolio manager of numerous institutional equity portfolios, and co-director of Lord Abbett's Equity Research Department.

Q. PLEASE SUMMARIZE YOUR EXPERIENCE THAT ALLOWS YOU TO PROVIDE TESTIMONY ABOUT THE VIEWPOINT OF INVESTORS.

A. As a securities analyst, I specialized in the electric utility industry and the individual companies comprising it. As a portfolio manager, I applied that knowledge, along with investment fundamentals, toward investment decisions on behalf of institutions and individual investors. And, as an advisor to the industry, a great deal of my work has dealt with investors and their perceptions.

Q. HAVE YOU EVER TESTIFIED BEFORE THIS COMMISSION?

A. Yes. I testified on behalf of SCE&G regarding the Company's cost of capital in Docket 2004-178-E. I also have submitted testimony before utility regulatory bodies in the states of Arizona, Connecticut, Kansas, Missouri, Nevada, Oklahoma, Pennsylvania, Virginia, Texas, and Washington.

Q. PLEASE SUMMARIZE THE KEY POINTS OF YOUR TESTIMONY.

A. My testimony in this proceeding has several primary themes: (1) it reviews the way that investors and investment analysts evaluate utility stocks in making decisions about including them or retaining them in their portfolios; (2) it evaluates how members of the investment community currently view SCANA and what effect the decisions made in this proceeding may have on that view; and (3) it discusses the capital requirements related to SCANA's plans to construct new nuclear capacity and the construction it must undertake to comply with new environmental regulations. In addition, I support the Company's position that an ROE of 11.75% would be seen as a reasonable rate of return for SCE&G in today's markets. Establishing a rate of return at that level will be very important to the ability of the financial community to support the Company as it seeks to raise capital to meet its service obligations in South Carolina.

ELECTRIC UTILITIES AS INVESTMENTS

Q. PLEASE EXPLAIN WHY THE INVESTMENT COMMUNITY'S VIEW OF AN ELECTRIC UTILITY'S STOCK IS IMPORTANT TO THE UTILITY AND ITS CUSTOMERS.

A. Electric utilities are in the business of providing the infrastructure needed to give their customers safe, reliable and efficient electric service. This is a very capital intensive business. In areas where populations are growing, and when new base load generation capacity is needed, a medium-size electric utility may need to invest hundreds of millions of dollars in capital to maintain and expand its system. How the investment community views a company will determine the price the company, and ultimately its customers, will pay for capital.

Q. PLEASE EXPLAIN HOW THE INVESTMENT COMMUNITY VIEWS UTILITY STOCKS AS INVESTMENTS.

A. In choosing stock to add or retain in a portfolio, investors typically consider stocks within certain sectors or categories as having a shared risk/reward profile. Stocks within these sectors or categories tend to move together with changes in market conditions because changes in market conditions tend to affect them in similar ways. The risk that the price of a stock will rise or fall based on overall changes in industry conditions is called sector risk. All stocks in a sector share in this risk. Individual stocks within a sector may rise or fall in value because of risks specific to that company. This company-specific risk is in addition to the sector risk that the company shares with its peers in the sector.

Historically, electric utility stocks have been chosen to reduce the risk level of portfolios because they have been regarded as providing stable performance through the ups and downs of market cycles and changing economic conditions. Electric utilities have typically earned a reasonable return even when the investment environment was not favorable for other companies. Accordingly, electric utility stocks have been particularly valuable holdings when conditions were not favorable to investments in more volatile industry sectors. In other words, investors might see greater returns from investment in other industries when times are good, but they stand to lose less on electric utility stocks when times are not good.

In addition, the reliability of electric utilities' earnings streams permitted most of the companies to continue to pay regular dividends during both good and bad economic cycles. For investors with a need for regular cash income, the prospect of regular dividends has been an important consideration in making a decision to invest in electric utility stocks.

Based on these factors, investors have traditionally viewed electric utility stocks as bond substitutes. In other words, electric utility stocks have provided regular cash returns in the form of dividends and the shares themselves were seen to have a stable underlying value. Electric utilities historically have paid out a large proportion of their earnings as dividends, and their large construction programs have kept them dependent on the capital markets. As a result, electric utility stocks as a group have tended to move closely in line with the direction of interest rates, but in an inverse relationship. That is, utility stock prices rose when interest rates fell, and vice versa.

Q. HAVE THE RECENT CHANGES IN THE INDUSTRY INCREASED THE RISK OF INVESTING IN ELECTRIC UTILITIES?

A. Yes. The predictability of the electric utility industry's earnings, across the sector, was undermined in the last ten to fifteen years by the restructuring of the industry that has taken place in many parts of the country. Presently, the onset of a significant new construction cycle is seen as posing a new and significant challenge to the electric utility sector. The fact that some of the new construction will be for nuclear capacity introduces another meaningful layer of risk and concern. In addition, regulatory exposure has become a key focus for investors as utilities face a series of rate cases related to infrastructure hardening and expansion, environmental requirements, and other cost increases. These risks are in addition to those posed by technological, economic, environmental and other policy changes that affect the industry. These increased risks mean that investors no longer perceive electric utilities as a group as being as much the "safe havens" they once were.

Investors' goals, however, have not fundamentally changed. They still look to electric utilities primarily as defensive investments, and still look for stable performance and regular dividends as the reason to invest in electric utilities. But investors also understand that the investment risk in electric stocks has risen significantly, and that there is considerable risk that investors' goals in investing in this sector may be frustrated. In the end, investors have a very large universe of stocks from which to select; with few exceptions, they have no requirement to own electric utility stocks. Consequently, investors now require significant returns for investing in the electric utility industry to balance the increased risk associated with it.

Q. YOU MENTIONED THE INDUSTRY'S CURRENT CONSTRUCTION CYCLE AS A RISK. PLEASE ELABORATE.

A. In its annual regulatory study, *Capital Complications*, Lehman Brothers explores extensively the ramifications of the current construction cycle. The brokerage firm's global conclusion is "...***that expanding capital programs***

and increasing cash shortfalls threaten company and shareholder returns [emphasis added].'"[1] The study goes on to say:

- A robust capital spending program throughout the industry exacerbates cash flow issues, as capex levels look to settle above $50 billion a year, almost double the levels of 2004. FCF [free cash flow] appears negative by as much as $16 billion a year post-dividend, and negative $4 billion pre-dividend, in the next few years.
- The need for external capital to fund dividends and capital programs is beginning to grow. We estimate that approximately $60 billion of external debt and equity funding will be necessary by the end of 2010.
- Complicating this picture further for regulated utilities will be the need to seek more frequent rate increases to fund rate base growth. Historically, more trips to the regulator, coupled with rate increase requests to fund larger capital budgets, have resulted in a compression of allowed returns and significant effects from regulatory recovery lag.
- We believe that the quality of regulation will play a larger role in stock selection, as this capital cycle wears on. We focus on jurisdictions that favor settlement over litigation, performance-based regulation over traditional ratemaking, and those in which infrastructure growth is incentivized with healthy returns.[2]

Q. HOW DO INVESTORS SELECT INDIVIDUAL UTILITY STOCKS TO ADD TO THEIR PORTFOLIOS?

A. Initially, an investor would make a decision to add to his or her portfolio a stock that would offer stability and cash returns. The question then becomes how to meet that goal with the least risk and the highest likelihood of a return. Assuming the investor chooses to invest in the electric utility sector, the question then becomes what stock or group of electric utility stocks to add to

[1] Lehman Brothers, "Capital Complications," May 2007.
[2] Ibid.

the portfolio. At that point, the company-specific risk factors become relevant. Company-specific risk factors include such things as the size and scope of the company's operations (larger size means more ability to absorb specific financial set-backs), the degree of regulatory risk and the diversity of that risk (operating in multiple jurisdictions means a bad result in one jurisdiction has less overall impact on the utility's results), the quality and stability of management, the company's environmental risk (in other words, the cost of meeting future environmental standards), and the future capital expenditure plans of the company (the more capital the company must raise, the greater its exposure to potentially unfavorable markets and possibility of dilution of returns). Based on an assessment of all these factors, the investor makes a decision to invest in a particular utility company or group of companies.

Q. CAN YOU SUMMARIZE HOW THE INVESTMENT COMMUNITY VIEWS SCE&G AND ITS PARENT COMPANY SCANA?

A. Yes. Historically, SCANA has been viewed favorably as being a traditional, vertically integrated utility in a state with a relatively constructive regulatory environment. The Company is seen as having maintained focus on its core energy businesses over the years and not having been unduly distracted by non-energy related ventures.

However, SCANA is a mid-cap stock, and SCE&G's future capital expenditure plans are becoming a matter of concern in the investment community. This is not surprising given that SCE&G will invest nearly half a billion dollars in new environmental upgrades over the next two and a half years and that it has announced plans to build new nuclear capacity in partnership with Santee-Cooper.

Q. DO INVESTORS' FAVORABLE OPINIONS ABOUT REGULATION IN SOUTH CAROLINA INDICATE THAT THEY PERCEIVE REGULATION IN THE STATE TO BE BIASED TOWARD INVESTORS?

A. Not at all. Investors see regulation in South Carolina as balanced and constructive. By this I mean that regulation has historically balanced the interests of investors and consumers in an even-handed and constructive way – one which I believe benefits all parties.

This conclusion is demonstrated by a recent report by Lehman Brothers that provided a ranking of state utility commissions from an investor perspective. Tier 1 was "Most Shareholder Oriented" and Tier 5 was "Most Consumer Oriented." Lehman Brothers ranked South Carolina in "Tier 3" on this scale –exactly in the middle.[3] This ranking indicates that investors see regulation in South Carolina as fairly balancing the interest of consumers and investors in a way that maximizes the interest of both.

Q. IS IT POSSIBLE FOR A COMMISSION TO BE SEEN AS BEING FAIR TO BOTH CONSUMERS AND INVESTORS?

[3]Lehman Brothers, "Capital Complications," May 22, 2007.

A. Yes. As discussed in more detail below, what investors value most in utilities is stable earnings and regular dividends supported by consistent and fair regulation. Where regulation is seen as providing such stability, investors are comfortable making capital available to utilities on reasonable terms. Reasonably priced capital greatly benefits the utility's customers in the form of reduced capital costs. Fairness to investors and fairness to customers are not mutually exclusive but actually go hand in hand.

Q. HOW HAVE CONCERNS ABOUT NUCLEAR CONSTRUCTION APPEARED IN THE MARKET?

A. Moody's Investors Service ("Moody's") rates the Company's senior secured debt A1. This rating is higher than the comparable rating by its sister rating agencies. However, on May 31, Moody's placed SCE&G's ratings, along with all others for its parent and sister companies, on review for possible downgrade. According to Moody's:

> The review for possible downgrade for SCANA and its rated subsidiaries primarily reflects our expectation for a weakening financial profile over the near and intermediate-term horizon. The company's financial profile is expected to deteriorate as a result of the significantly increased capital expenditure program and with management's decision to fund this program primarily with debt.[4]

Q. PLEASE COMMENT ON MOODY'S OPINIONS OF THE COMPANY.

A. The rating agency has consistently acknowledged the constructive South Carolina regulatory climate in its assessment of the utility. However, Moody's

[4] Moody's Investors Service, "Credit Opinion: South Carolina Electric & Gas Company," May 31, 2007.

is sufficiently concerned about SCE&G's major capital expenditure program and the anticipated pressure on financial metrics that it placed the Company's (and SCANA's) bond ratings on review for possible downgrade. The rating agency also over a year ago raised a cautionary flag about SCE&G's plan to build new nuclear generation; what was then in the formative stages is now closer to becoming a reality.

Q. WHAT ARE THE IMPLICATIONS OF A CREDIT DOWNGRADE?

A. As will be discussed later in my testimony, a credit downgrade at a minimum results in a higher cost of debt. Because SCANA has indicated its intention to finance its construction program through debt, cost pressures on the Company will increase. In turn, that could require the utility to seek additional rate relief, which would result in higher rates to customers.

Q. HOW ARE SCE&G'S PLANS TO BUILD NEW NUCLEAR CAPACITY VIEWED BY THE INVESTMENT COMMUNITY GENERALLY?

A. At present, the investment community is awaiting confirmation that SCE&G in fact intends to proceed with nuclear construction. While SCE&G has announced its intention to build new nuclear capacity, as of the date of this testimony, no contract for the plant has been signed, nor have prices or capital requirement been publicly disclosed. On the one hand, the investment community understands that the final decision to proceed with the new capacity depends on a number of factors, including whether there is regulatory support in South Carolina for new capacity that is sufficient to support the cash needs of the Company during construction. Until these matters are better understood, the investment community will consider any decision to proceed with nuclear construction to be tentative. As the experience with utility and non-utility generator shows, not all announcements of the intent to build a plant results in plants actually being built.

In addition, the investment community does not have the information it needs to accurately assess the effect of the nuclear construction plans on the Company's finances. Prices and construction schedules will not be disclosed until a contract is signed, and even so, prices are not likely to be finally fixed until sometime later. Until prices and schedules are more fully known, and the Company's financial strategy for dealing with these costs is disclosed, utility analysts will not have the data necessary to model the effects of nuclear construction on SCANA's finances.

Q. WHEN FACTS ABOUT CONSTRUCTION COSTS AND SCHEDULES ARE KNOWN, WHAT WILL THE INVESTMENT COMMUNITY DO TO ASSESS THESE NEW FACTS?

A. When the contract is announced, and the construction costs and schedule of payments are disclosed, investors will begin to model the effects of those costs on SCE&G's and SCANA's finances. These analysts maintain sophisticated financial models of companies like SCE&G and SCANA. They will input the capital required for the new nuclear capacity into those models, and may consider what the Company has said about how it intends to finance those costs. Based on this information, and analysts' assumptions about things like the ROE that will be allowed in future rate adjustments, the investors will compute the effect of the construction budget on the Company's earnings growth, dividends payout, debt coverage ratios and other key financial metrics. If these investment analysts conclude that the Company can undertake the construction without unduly jeopardizing SCANA's position as a stable investment with dependable dividends, then they will continue to buy or hold SCANA stock. If they conclude that SCANA's financial plan will not support these capital expenses without jeopardizing future returns, then they will sell off the stock, and raise the required return on bonds, increasing the Company's capital cost, and potentially preventing it from financing the construction plan at reasonable rates.

Q. WHAT ROLE WILL HEDGE FUNDS PLAY IN THIS PROCESS?

A. As the Commission is aware, hedge funds are well known for trading in information; their actions are frequently event-driven. Sometimes that information is factual and other times it falls into the category of rumor. Because investors at hedge funds have wide information networks and are in frequent communication with companies and a broad range of other investors, they have the ability and the power to create volatility, which in turn impacts the movement of stock prices. The number of hedge funds participating in the market and the funds' assets have grown exponentially in recent years. Recent estimates put the numbers at over 8500 firms with assets of $1.26 trillion globally in 2005, with the top 134 U.S. hedge funds' assets at almost $631 billion. That compares to only 610 firms with $39 billion in assets in the U.S. in 1990. Hedge funds clearly have become a very strong force both in the market and in stocks in which they are interested. When they like an industry group or a stock, hedge funds can provide substantial support to stock prices. But conversely, when they become disenchanted, their tendency is to sell quickly and without remorse. Although their focus is not on contributing to orderly markets, hedge funds are a formidable presence in the market place and must be reckoned with.

Q. CAN YOU GIVE AN EXAMPLE OF HOW HEDGE FUNDS MIGHT TRAFFIC IN SCANA'S STOCK?

A. Yes. Earlier in the year, SCE&G announced its intention to file the current rate case. Hedge funds assuredly made assumptions about the details of the case, including its resolution, prior to the filing. If, when the Commission's decision is ultimately announced, the details fall short of those expectations, the hedge funds could put significant pressure on the stock either through outright sales, or short-selling, i.e. selling stock that is borrowed in anticipation that the price of the stock will drop before the borrowed stock must be replaced. Hedge funds seek to get ahead of the broader market and react to news before the market can. Accordingly, if hedge funds decide to make moves on SCANA's shares based on the order in this proceeding, they will begin to do so within hours of the release of the order.

Q. CAN RECENTLY ENACTED LEGISLATION IN SOUTH CAROLINA REDUCE THE RISK ASSOCIATED WITH NEW NUCLEAR CONSTRUCTION?

A. The Base Load Review Act will, indeed, lower the risk connected with new nuclear facilities, but it will not eliminate it. As noted in a recent report from Goldman Sachs, the legislation has provisions supportive of new construction, such as:

> 1) Cash returns during construction, with annual revised rate adjustments (RRA);
> 2) Ability to request a project-specific RoE that differs from the authorized utility level;
> 3) Pre-determination and approval of costs, prior to construction;
> 4) Incentives for nuclear development not offered for coal generation; and
> 5) Allowed returns on capital invested, even if a plant is "abandoned" or cancelled prior to completion.[5]

But even with the Base Load Review Act in place, the Company remains at risk for completing the new capacity within the approved budget and prices. As Goldman notes, "prudency reviews and cost overruns are key risks for SCANA."[6] The Base Load Review Act provides the Company with important tools for supporting its financial integrity during a base load construction cycle. But it does not eliminate the risk from such construction.

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[5] Goldman Sachs, "SCANA Corp.: South Carolina on our mind—a leader in nuclear development," May 29, 2007.
[6] Ibid.

Q. ARE THERE ADDITIONAL FACTORS TO CONSIDER IN REGARD TO THE COMPANY'S PLANNED CONSTRUCTION OF A NUCLEAR PLANT?

A. Yes, there are. It bears further mention that SCANA is a relatively small company. Construction of a base load nuclear plant will constitute a very large commitment for it relative to its size. In investors' eyes, that commitment will simply increase the risk component of an investment in SCANA. I would also mention that there are many investors who lived through the post-Three Mile Island days of the late 1970s and 1980s. I recall well what a challenging experience it was to make investments in utilities and the enormous amount of shareholder wealth that was destroyed during that period. While many factors are different today—the nuclear construction and licensing process, nuclear technology and safety, not to mention the interest rate climate—investors still have long memories. I believe they will require a significant risk premium today to take on nuclear risk.

Q. WHY IS THE PERCEPTION OF REGULATORY CLIMATE OF SUCH IMPORTANCE TO INVESTORS?

A. Equity investors today are still seeking companies that can offer stability in earnings and dividends; indeed, investors such as Merrill Lynch[7] specifically see SCANA as providing such attributes. Fixed income investors look for stable and adequate cash flows to ensure payment of principal and interest

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[7] Merrill Lynch, "Slow Start to the Year," May 1, 2007.

when due, as indicated by stable credit ratings. The ability to pay dividends and sustain credit ratings is directly related to the consistency and sufficiency of a utility's earnings, which depend in large part on how the utility is regulated. If there is uncertainty about whether regulation will allow a utility the opportunity to earn a reasonable return in future years, then that uncertainly will lead investors to avoid holding investment positions in the utility, all other things being equal.

As a result, I believe that investors selecting electric utility stocks today place a very high value on consistent and constructive regulation. And with a new round of base rate case filings underway in the industry, I think it is likely that the quality of regulation will receive renewed investor attention.

RETURN ON EQUITY FOR SCE&G

Q. HOW DO YOU BELIEVE SCE&G'S REQUESTED RETURN ON EQUITY OF 11.75% COMPORTS WITH INVESTORS' PERCEPTIONS?

A. I believe that the investment community would find an 11.75% ROE reasonable for SCE&G and that it would be seen as a signal that the history of constructive regulation is being carried forward in South Carolina. This ROE represents a reasonable increase in the current allowed ROE range of 10.4%-11.4% range that was granted two years ago in the Company's last electric rate proceeding. It is particularly reasonable considering the new risks the utility is incurring with heightened capital expenditures that include a planned new nuclear plant.

Q. WOULD YOU PLEASE COMMENT ON DR. MURRY'S ROE RECOMMENDATION?

A. Dr. Murry's proposed range of reasonableness for an equity return is 11.75% to 12.0%. The Company filed its rate request in this proceeding using an 11.75% ROE.

In my opinion, this would be seen as a reasonable and constructive ROE in the present context. Investors are aware of SCE&G's capital expansion plan and of the Company's stated intention to build a new nuclear plant. Investment risk in the electric utility industry is higher than it has been, and investors are requiring greater levels of compensation to assume that added risk. As an input in valuation models, earnings levels logically translate into the attractiveness of a stock, other factors being equal. A reasonable ROE award should sustain the Company's earnings power and affect the potential for future dividend growth. Conversely, a lower ROE could potentially undermine investors' expectations for ongoing dividend growth.

An additional reason for supporting at least an 11.75% ROE is related to the Base Load Review Act. While the Act does allow project-specific ROEs, it is also possible that the ROE from the Company's most recent rate case will be used in computing rate revisions under the act. That means that the ROE established in this proceeding could be the ROE, under the Base Load Review

Act, that is applicable in computing rate adjustments during construction of the nuclear capacity. That ROE will help create the cash flow needed to support the finances of the Company during construction. As noted above, investors will require an ROE commensurate with the risk that they will be assuming in supporting construction of that facility. These are important reasons why I would support Dr. Murry's recommended ROE range.

Q. COULD AN ROE AWARD THAT IS CONSISTENT WITH INVESTOR EXPECTATIONS ALSO BE EXPECTED TO PROVIDE BENEFITS TO SCE&G CUSTOMERS?

A. Absolutely. A higher ROE permits the realization of a stronger earnings stream. In turn, that can improve a company's stock's valuation prospects, which results in a higher stock price. Thus, when a company needs to tap the equity markets for capital needed to meet customer needs, it can get more for its money. Said another way, each share sold brings more equity into the Company with the same commitment by the Company to generate earnings and pay dividends to support the value of that share. In regard to debt financing, a higher ROE awarded to SCE&G would be viewed as a sign of constructive regulation and would be positive for the Company's credit rating. Importantly, customers' rates will eventually reflect this lower cost of capital.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes.

Exhibit ___, (JMC-1)

JULIE M. CANNELL
P.O. Box 199
Purcbhase, New York 10577

BUSINESS EXPERIENCE:

1997-	J.M. CANNELL, INC.	
		President of firm providing advisory services specializing in the electric utility industry.
1977 - 1997	LORD ABBETT & COMPANY, New York, New York	
1995 - 1997		Equity Portfolio Manager. Responsibility for management and client servicing of ten institutional equity portfolios with total assets in excess of $700M. Actively and successfully involved in new institutional business marketing effort.
1994-1996		Associate Director of Equity Research. Provided oversight of departmental activities, including supervision of analysts' research efforts and support staff functions.
1992-1995		Portfolio Manager, America's Utility Fund. Full portfolio management responsibility for the fund since its May 1992 inception.
1978-1995		Securities Analyst. Sole responsibility for analysis of and stock recommendations for the electric utility and telecommunications industries. Other areas of coverage previously included housing (2 years) and pollution control (1 year).
Summer 1977		Research Assistant in Utilities.
1973-1976	UNIVERSITY OF COLORADO. Colorado Springs, Colorado.	

Public Services Librarian
Instructor in Bibliography to undergraduate and M.B.A. students

1971-1973 CAMERON COLLEGE, Lawton, Oklahoma.

Reference Librarian

EDUCATION:

1978	COLUMBIA UNIVERSITY, MBA - Finance
1971	EMORY UNIVERSITY, M.Ln. - Librarianship
1970	MARY BALDWIN COLLEGE, B.A. - English

MEMBERSHIPS:

Chartered Financial Analyst (C.F.A.)
New York Society of Security Analysts
Association of Investment Management & Research
Wall Street Utility Group